Supreme Court, U.S.
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No. 01-

IN THE

Supreme Court of the United States

A.D. BEDELL WHOLESALE COMPANY, INC., TRIANGLE CANDY & TOBACCO CO., on behalf of themselves and all others similarly situated,

Petitioners,

v.

PHILIP MORRIS INCORPORATED, R.J. REYNOLDS TOBACCO COMPANY, INC., BROWN AND WILLIAMSON TOBACCO CORP.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The four largest cigarette manufacturers, having a 98% share of the nationwide market, entered into a settlement agreement with 46 States to resolve lawsuits brought by the States against them. The settlement agreement contains provisions that substantially penalize any firm entering into that agreement including smaller competitors, who later signed on to the agreement for exceeding their agreed upon output. Two cigarette wholesalers brought this antitrust action on behalf of all direct buying wholesalers claiming that the output restriction is illegal *per se* under the antitrust laws. The court below held that the manufacturers' acts in furtherance of the output restrictions were immune from antitrust scrutiny under the *Noerr-Pennington* doctrine even though they did not qualify as state action under this Court's decision in *Parker v. Brown*:

1. Does the *Noerr-Pennington* doctrine immunize an output cartel controlling an entire interstate market because the provisions creating it were inserted into a settlement agreement with a group of states?

2. Does the *Noerr-Pennington* doctrine apply to an output cartel's post-petitioning anticompetitive conduct that has no antitrust immunity under state action doctrine?

3. Do the Supremacy Clause, the Commerce Clause and the Compact Clause preclude a group of States from using the *Noerr-Pennington* doctrine to immunize the operation of an interstate output cartel?

LIST OF ALL PARTIES IN THE PROCEEDING AND CORPORATE DISCLOSURE STATEMENT

All parties to the proceeding are identified by name in the caption. Neither of the petitioners, A.D. Bedell Wholesale Company, Inc., nor Triangle Candy & Tobacco Co., are subsidiaries or affiliated with any other corporation, and no publicly-held company owns 10% or more of the stock of either of these petitioners. This is a class action brought on behalf of all direct buying wholesalers of cigarettes from the respondents. Prior to its dismissal, however, no certification was made.

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A.D. Bedell Wholesale Company, Inc. and Triangle Candy & Tobacco Company, on behalf of themselves and all others similarly situated, petition the Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit.

OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Third Circuit is reported at 263 F.3d 239 (3d Cir. 2001) and reprinted at petitioners' appendix (Pet. App.) at 1a-62a. The Opinion of the United States District Court for the Western District of Pennsylvania dismissing the complaint herein and denying petitioners' motion for partial summary judgment on the issue of liability under Section 1 of the Sherman Act, 15 U.S.C. § 1 is published at 104 F. Supp. 2d 501 (W.D. Pa. 2000) and reprinted at Pet. App. at 65a.

STATEMENT OF JURISDICTION

The Court of Appeals entered judgment on June 19, 2001 and denied petitioners' petition for a rehearing and suggestion for a rehearing *en banc* on July 24, 2001. Pet. App. at 88a. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

U.S. Constitution

Art. VI, Clause 2. Supreme Law of Land

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof: and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Art. I, Section 8. The Congress shall have Power To lay and collect Taxes, Duties, Imports and

Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

Clause 3. To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

Art. I, Section 10. Clause 3. No State shall, without the Consent of Congress, lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.

The Sherman Act

15 U.S.C. § 1. Trusts, etc., in restraint of trade illegal; penalty

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

15 U.S.C. § 2. Monopolizing trade a felony; penalty

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commence among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine

not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

STATEMENT OF THE CASE

This is a class action under the antitrust laws brought under 15 U.S.C. §§ 15, 16 and 28 U.S.C. § 1331, giving the federal district courts exclusive jurisdiction of such actions.

A. Preliminary Statement

This case presents an issue of critical importance to the interpretation and application of the federal antitrust laws. The court below decided that a restraint of trade agreed to and implemented by private parties that fails to qualify for state action protection under *Parker v. Brown*, 317 U.S. 341 (1943), is nonetheless immune from antitrust scrutiny under the *Noerr-Pennington*[1] doctrine whenever the private parties request to have the restraint incorporated into a settlement agreement entered into with a group of states.

That decision conflicts with decisions of this Court and recent decisions of the Circuit Courts of Appeal. Indeed, the decision would effectively eviscerate *Parker* if it were allowed to stand. Under the lower court's reasoning, the conduct of private parties and restraints of trade that fail to satisfy the state action doctrine, either because they are not clearly articulated as state policy or closely supervised, are immune from scrutiny whenever the parties lobby or request a state government to agree to the restraint. The lower court failed to recognize, however, that *Noerr-Pennington* does not apply to the subsequent operation of a restraint or its implementation by private parties. Thus, immunity for the subsequent operation of the cartel and the acts of its members must be judged under *Parker, not Noerr-Pennington*; and, as the court below decided,

1. *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

the restraint and conduct causing antitrust injury fails to qualify for state action protection.

This case also presents an issue of critical importance to the limits of the encroachment by a group of states upon the powers of the federal government in regulating interstate commerce. It transcends the legality of the cartelization of the industry involved here — the nationwide cigarette market. The cartel was created in an agreement called the Master Settlement Agreement ("MSA") made between the major manufacturers and 46 states to settle claims arising from state expenditures for illnesses associated with smoking.[2] Under the rationale of the lower court's decision (hereafter sometimes referred to as the "Opinion"), such industry-wide cartels can now be created through settlement agreements between a combination of states and the major firms in any industry, the only limitation being an industry concentrated enough to enable such a cartel to work effectively. The gun industry, the oil refining industry (pollution from benzene), and the heavy truck industry (pollution from carbon particulate matter, nitrogen oxide, and damage to state roads) are obvious candidates.

Indeed in the amicus brief submitted by the states to the Third Circuit in this case, they maintained that it is "vital" for the States to "remain free to engage in meaningful settlement negotiations with private parties they sue and to conclude settlement agreements with them." Amicus Brief of Settling States at 4. The cartel validated by the Opinion presents a win-win situation for the cigarette companies on the one hand and the states on the other. It enables the cigarette companies and the states to split annually billions of dollars in supracompetitive revenues generated by the restraints of trade

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2. In addition, six other governmental entities (the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, Guam and the Northern Mariana Islands) joined the MSA. They, together with the 46 States, are defined in the MSA as the "Settling States". Joint Appendix submitted to the Third Circuit in this case (hereinafter referred to as "JA") at 105 (MSA § II (qq)-(rr)).

embodied in the settlement agreement. The ultimate losers are wholesalers and the millions of consumers of cigarettes.[3]

Moreover, even if settlements made with states were entitled to *Noerr-Pennington* immunity, granting such immunity to the acts implementing cartelization of a nationwide industry encroaches on the enumerated powers of the federal government. It directly interferes with interstate commerce in violation of the Commerce Clause, U.S. Constitution, Art. I, § 8, cl.3 and the Compacts Clause, U.S. Constitution, Art. I, § 10, cl.3.[4]

B. The Facts

The facts are accurately stated in the Opinion and will only be briefly summarized here. The three defendants, together with a fourth cigarette company (the "Majors") had 98% of the nationwide cigarette market in November, 1998. Pet. App. at 4a. At that time, they entered into a multi-state settlement agreement with the Settling States, the so-called Master Settlement Agreement ("MSA"), in which they agreed to make annual multibillion-dollar payments in perpetuity. Pet. App. at 49a-51a; JA 126 (MSA § IX(c)).[5]

1. The Failed Congressionally Sanctioned National Settlement

Starting in the mid-1990's, a number of states filed claims against the Majors seeking to recover health care costs associated with illnesses relating to smoking. The Majors sought to settle these claims by getting most of the states' attorneys general to agree in the Spring of 1997 to seek to obtain congressional enactment of a proposed national legislative settlement. JA 400.

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3. The direct-buying purchasers, mostly wholesalers, the class suing here, are the only parties with standing to seek antitrust damages from the defendants. *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

4. As discussed *infra*, p. 28, the Opinion's assertion that the petitioners did not raise the Commerce Clause and Compact Clause arguments in the district court is incorrect.

5. The MSA and the exhibits thereto are also available on the website of the National Association of Attorneys General (hereafter "NAAG"): www.naag.org.

The Majors and the States then presented a proposed national settlement to Congress in June 1997, which provided for the same sort of output cartel subsequently embodied in the MSA. Proposed Tobacco Industry Settlement, June 20, 1997[6]; *see also* Pet. App. at 5a.

The 1997 National Settlement Proposal would have required annual payments which were much larger than those called for in the MSA — about $15 billion per year and aggregating approximately $368 billion over twenty-five years,[7] *id.* at Title VI(B), and were structured so that they would force smokers to pay for all of these costs by means of a pass-through. The FTC estimated the pass-through costs to consumers for funding this settlement at somewhere between 57¢/pack and 99¢/pack over that 25-year period. FTC Report on Competition and the Financial Impact of the Proposed National Tobacco Settlement (JA 497, 540) (September 1997) (hereinafter the "September 1997 FTC Report"). The FTC estimated that the manufacturers could finance the entire proposed $368.5 billion settlement by raising prices during this 25-year span by a *total* of about 60¢/pack.[8] JA 540.

The 1997 National Settlement Proposal would have protected the Majors from any competitive disadvantage versus existing smaller competitors or others, who might thereafter enter the market and use their cost advantage to take market share away from the Majors. It contained the prototype for the restriction on output ultimately embodied in the MSA. It classified as a "Non-Participating Manufacturer" ("NPM"),

6. Available at http://www.cnn.com/us/9705/tobacco/docs/proposal.html (last visited June 18, 2001).

7 By contrast, under the MSA, assuming that efficient policing of the cartel results in the Majors' losing little or no market share to competitors, they will pay to these states about $211 billion over a 25-year period. JA 125-26 (MSA §§ IX(a), (b) and (c)).

8. Even though the MSA annual payments are many fold less than this $15 billion, the Majors have now raised prices by more than 60¢/pack. JA 679-80. That sum was the total aggregate price rises postulated by the FTC needed to fund the $368.5 billion settlement over 25 years.

Proposed National Tobacco Settlement at Title III (C), all cigarette makers except for the four Majors; and provided, for example, that an NPM which captured 2% of the domestic cigarette market would be forced to pay 3% of the $15 billion annual settlement payments ($450 million), rather than having to pay merely 2% of the allocable settlement payment that the Majors would otherwise have to pay for that same market share ($300 million or 2% of $15 billion), *i.e.*, a penalty of $150 million. *Id.* The Majors' aliquot share of the $15 billion settlement would be correspondingly reduced by $450 million. Such a penalty, of course, would have effectively prevented the NPM's from capturing market share through price competition, thereby preserving the output cartel.

The 1997 National Settlement Proposal explicitly provided an additional exemption from the antitrust laws for the Majors. This proposed exemption would have permitted them to "jointly confer, coordinate or act in concert, for this limited purpose [of achieving the goals of the settlement]." *Id.* at Appendix IV (C)(2); *see also* JA 557 (FTC evaluation).

In September 1997, the FTC's formal evaluation of the proposed settlement condemned the proposed output cartel contained in the settlement as a vehicle for generating supracompetitive revenue for the Majors. JA 517, JA 534. In subsequent testimony before Congress in October 1997, FTC Chairman Pitofsky specifically objected to the excessive profits the Majors would make:

> The analysis contained in the FTC Staff Report demonstrates that approximately two-thirds of any additional revenues generated as a result of increased industry coordination will go to the manufacturers as excess profits.[9]

9. This is roughly the same split as the Majors achieved with the MSA. However, the actual price rises already made by the Majors since the MSA was executed in November, 1998, 63¢/pack (exclusive of the 10¢/pack federal excise tax increase on 1/1/00), are much higher than those posited by the FTC. Hence, the Majors are making far more (Cont'd)

Prepared Statement of FTC Chairman Pitofsky before the Subcommittee on Antitrust, Business Rights and Competition, October 29, 1997.[10] He then pointed out that the "antitrust exemption could permit firms to raise cigarette prices beyond the level necessary to satisfy payments under the settlement, resulting in a windfall to the industry." *Id.* As discussed below, this is what the Majors have accomplished through the MSA.

2. The Majors and the States Strike a Deal Without Congress

The FTC's opposition resulted in the scuttling of the 1997 National Settlement Proposal. Pet. App. at 7a. By early 1998, the Majors had settled health care lawsuits with four states, Florida, Mississippi, Texas and Minnesota, totaling about $40 billion in payments to those states over twenty-five years.[11] JA 400. In the Spring of 1998 the Majors restarted the negotiations with the remaining state attorneys general and the private plaintiffs' attorneys with the output cartel still the centerpiece of the proposed negotiations but this time with no antitrust exemption. The deal culminating in the MSA containing the provisions for an output cartel without an antitrust exemption was executed as of November 23, 1998. Pet. App. at 7a; JA 85-247.

The MSA also differed from the earlier proposed national settlement in several significant respects — all of which favored the Majors. First, as noted above, the payments to the states were substantially less, about 60% of what the national settlement would have required, thereby enabling the Majors to retain more of the excess revenue generated by the cartel.

(Cont'd)
supracompetitive profits under the MSA than those projected by the FTC under the failed national settlement.

10. Available at http://www.ftc.gov/os/1997/9710/tobacco.tes.HTM.

11. Those four states are not parties to the MSA, but the Majors can deduct the payments to them from the payments due under the MSA — the so-called Non-Settling States Reduction. JA 102 (MSA § 2(dd)).

See supra p. 6. Second, the tobacco industry would not be regulated by the FDA or required to print additional and stronger health warnings on cigarette packs. Third, the Majors could continue sports promotions of brand labels and cigarette advertising, both in print and at retail stores. In addition, MSA §§ III(c)(2)(i), III(c)(3), III(f), III(i) gave the Majors grandfather rights for brand name sponsorship, giveaways of merchandise and promotions. JA 107-111. Fourth, the private plaintiffs' attorneys assisting the states' attorneys general are now receiving and will continue to receive billions of dollars in fees from the operation of the cartel. JA 163 (MSA § XVII(d)); JA 207-24 (MSA Exh. O); JA 163 (MSA § VII(d)); JA 201-24 (MSA Exh. D).

3. The Provisions in the MSA Setting Up the Output Cartel

The provisions of the MSA setting up the output cartel are described in the Opinion (Pet. App. at 7a-16a and 19a-21a) and will only be briefly summarized here. They consist of an interlocking combination of three provisions: the so-called Renegade Clause, MSA § IX(i), the provision for States' enacting escrow statutes, MSA § IX(d)(2)(B)(D) and (E), and Exhibit T to the MSA (the so-called "Model Statute" discussed in the Opinion (Pet. App. at 12a-15a)), and the NPM Adjustment for Original Participating Manufacturers ("OPM's"), MSA § IX(d)(1), quoted in full and discussed in the Opinion. Pet. App. at 9a-12a.

If a small manufacturer joins the MSA, thereby becoming a "Subsequent Participating Manufacturer" ("SPM") or refuses to join, thereby becoming a "Non-Participating Manufacturer" ("NPM"),[12] any attempt to increase its output is effectively penalized so as to enable the Majors to raise prices to artificially high levels without losing significant market share. If it joins the MSA as an SPM, the small manufacturer is required by the terms of the Renegade Clause to pay substantial penalties for

12. These are defined terms in the JA 102, 106 (MSA §§ II(cc) & (tt)).

exceeding the greater of its 1998 market share or 125% of its 1997 market share. JA 137 (MSA IX(i)(1)). This penalty, approximating about 40% of the wholesale price, net of the penalty, thereby effectively discourages price competition.[13]

On the other hand, if a small manufacturer declines to join the MSA as an SPM, it is subjected to even stiffer penalties as an NPM under the Escrow Statutes. The MSA penalizes the Settling States unless they use their best efforts to enact an Escrow Statute, which must contain the provisions of a "Model Statute." JA 131, 241-45 (MSA Exh. T).[14] These Escrow Statutes constitute the last turn of the screw making this output cartel watertight. In the MSA, the Majors and attorneys general agreed to impose severe penalties by way of reduction of settlement payments on any state that did not enact an Escrow Statute. This so-called NPM Adjustment results in a substantial reduction in annual settlement payments to that particular state. JA 131 (MSA § IX(d)(2)(F)). Not surprisingly, all of the Settling States have now enacted Escrow Statutes. Section IX(d)(2)(E) of the MSA explicitly confesses the anticompetitive purpose of these Escrow Statutes: to establish a means "that effectively and *fully neutralizes the cost disadvantages* that the Participating Manufacturers experience *vis-a-vis* Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement." *Id.* at JA 131, emphasis added. To make sure that the States enforce the Escrow Statutes,

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13 *See* Opinion (Pet. App. at 8a-9a). The 1999 penalty was about $1.90 a carton, or nearly 40% of the typical 1999 wholesale price of about $5.00 per carton for discount cigarettes. JA 476-77. For every carton of discount cigarettes an SPM sold in 1999 in excess of its market cap, the SPM had to pay over about 40% of the $5.00 it received. Operating margins, however, were substantially less than 40% (JA 441), thus making the penalty prohibitively expensive and forcing the SPM to raise prices and forego increased sales.

14. The Escrow Statutes also are defined as "Qualifying Statutes" under MSA § IX, thereby entitling the various state attorneys general to use the slush fund to lobby for their enactment and to enforce them.

the NPM Adjustment is triggered with respect to any State that does not "diligently enforce" its Escrow Statute. JA 130 (MSA § IX(d)(2)(B)).

The *in terrorem* effect of the Escrow Statutes on a potential new competitor in the discount end of the market is obvious. They coerce new entrants into paying for the past sins of the Majors by forcing them to pay an allocable share of the MSA payments, even though they have not been accused of and cannot in good faith be assessed for any wrongdoing.

The Escrow Statute penalties, which are roughly the same dollar amount as those imposed upon sales of SPM's in excess of their market cap under the Renegade Clause, are more severe because, unlike the MSA settlement payments, they are treated as fully taxable income, *i.e.*, after-tax dollars. They are non-deductible for income tax purposes because they are not "settlement" payments, 26 U.S.C. § 468B, and remain nominally the property of the NPM's, even though they are paid into a perpetual 25-year revolving fund that must be placed in a bank escrow account. JA 244 (MSA Exh. T); Pet. App. at 14a. At the end of 25 years whatever has not been paid out of the first year's payment is replaced by the penalties accrued in year 26, and so on in perpetuity. JA 244 (MSA Exh. T).[15] Although the Opinion characterizes the escrow payments as "a tax on new tobacco entrants of approximately $.27/pack in the year 2001, rising to $.36/pack by the year 2007" (Pet. App. at 13a-14a), the drafters of the MSA carefully defined these payments so as to avoid their being legally characterized as taxes. Had they been imposed as *de jure* taxes, they would have been facially discriminatory as favoring members of the cartel and thus *per se* violative of

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15. In the event an NPM does not make these escrow fund payments, the attorney general of each state is authorized to sue and assess a civil penalty on the recalcitrant NPM "in an amount not to exceed 5% of the amount improperly held from escrow per day of the violation and in a total amount not to exceed 100% of the original amount improperly withheld from escrow." JA 245 (MSA Exh. T).

the Commerce Clause. *See, e.g., Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270-72 (1984).[16]

To assure that the reach of the MSA output cartel extended nationwide, stretching into the four non-MSA states, Florida, Mississippi, Texas and Minnesota, the Escrow Statutes have an extraterritorial application. They require an NPM to make escrow payments on its cigarettes sold in Settling States "directly or through a distributor, retailer or similar intermediary." JA 244 (MSA Exh. T). Thus, if an NPM sells to Wholesaler X located in Minnesota, which in turn resells those cigarettes to Retailer Y in Wisconsin, that NPM must make escrow fund payments on the cigarettes sold at retail in Wisconsin. The direct interference with interstate commerce and violation of the NPM's civil rights under the Commerce Clause by enforcing this indirect sale requirement is obvious. *See, e.g., Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); *Dennis v. Higgins*, 498 U.S. 439, 446 (1991).

The result has been nearly total cartelization of the nationwide cigarette industry. This cartelization has enabled the Majors to overcharge wholesalers and ultimately the millions of purchasers of cigarettes throughout the entire country by billions of dollars annually and, unless this petition for certiorari is granted, in perpetuity.

To date, the cartel has satisfied the full expectations of its participants. On November 23, 1998, the day after the MSA

16. The extraterritorial reach of these statutes has been sustained on the precise ground that they are not sales taxes. *Star Scientific, Inc. v. Carter*, Civ. Act. No. IP01-0838, 2001 WL 1112673 (S.D. Ind. Aug. 20, 2001). The constitutionality of these Escrow Statutes was unsuccessfully challenged on grounds other than their being preempted by the Sherman Act and violative of the Commerce Clause by virtue of their constituting a nationwide restraint on interstate commerce illegal under the Sherman Act. *Star Scientific, Inc. v. Earley*, No. 3:00CV835 (E.D. Va., Mar. 26, 2001). That decision is now on appeal to the Fourth Circuit, Appeal No. 1-1502. The lack of antitrust immunity under *Parker v. Brown* found by the court below was not raised by Star in the district court.

became effective, Philip Morris and R.J. Reynolds announced the largest price increase in the 100-year old history of this industry: 45¢/pack. Pet. App. at 15a-16a. B&W, Lorillard and Liggett quickly followed. This colossal price increase was the largest in dollar amount ever taken in the history of American marketing for any product: nearly $11 billion a year, *i.e.*, far more than the 19¢/pack necessary to make the $2.47 billion initial payment, as well as the next $4.5 billion payment which was due on April 15, 2000. JA 125 (MSA § IX(b)) and JA 126-27 (MSA § IX (c)). The 45¢/pack increase was more than double the amount that the Majors needed to fund the settlement. Pet. App. at 14a-16a.

Not content with the billions of supracompetitive revenues generated by this initial $4.50/carton price increase, at the end of August 1999 the Majors announced an additional wholesale price increase of $1.80/carton, generating an additional $1 billion in revenues for the last four months of 1999, none of which was necessary to fund the MSA payments due on April 15, 2001.[17] Then in January 2000, the Majors boosted prices by yet another $1.30/carton, and another $1.00/carton in April 2001. All told, these price hikes increased the cigarette revenues for the Majors nearly $14 billion for the year 2000, over twice as much as the payments required by the MSA.[18]

To summarize, to finance a settlement, the Majors realized as early as 1997 that they needed to have in place an output cartel. In 1997, Congress, at the urging of the FTC, denied them the *de jure* antitrust exemption that they had requested. Undeterred, in 1998 they proceeded to enter into the MSA with

17. The figure for the 1999 figure is derived by extrapolating from the Philip Morris for 1999 10K sales data available at www.sec.gov/Archives/edgar/data/764180/0000912057-00-009516.txt.

18. The $14 billion is computed by multiplying the estimated number of cigarettes to be sold in 2000, 2.15 billion cartons by the three price increases totaling 76¢ minus the 10¢ per pack increase in the federal excise tax effective in January 2000, or $6.60 x 2.15 billion cartons, by assuming that the output cartel enabled the Majors to retain at least a 96% collective market share for the year 2000.

the Settling States whereby those states agreed to bestow upon the Majors' monopoly profits for as long as the cartel set up in the MSA would last. Although the states came to destroy the Majors, they "settled" their healthcare claims by agreeing to collaborate with them to virtually eliminate all future competition and split the supracompetitive revenues generated by this restraint. They proclaimed "victory" over the Majors, but that victory consists of agreeing to take and in fact taking all steps they can to assure that the Majors' sales of cigarettes continues to prosper through the efficient operation of the cartel, thereby exploiting the millions of purchasers of cigarettes and rewarding the bad conduct of the Majors to the tune of billions of dollars. In a final piece of irony, the attorneys general have agreed to award the private plaintiffs' attorneys who assisted them in setting up this cartel with annual fees totaling billions of dollars. JA 162 (MSA § XVII (d)); JA 207-24 (MSA Exh. O).

REASONS FOR GRANTING THE WRIT

1. The Court Below Has Decided an Important Question of Federal Law in a Way that Conflicts with Relevant Decisions of this Court

The court below recognized that the *Noerr-Pennington* doctrine immunizes private parties from antitrust injury related to petitioning activity, *i.e.*, injury that results from the petitioning itself, but went on, however, to immunize injury not caused by the petitioning itself but rather the post-petitioning anticompetitive conduct of private parties. Pet. App. at 24a-32a, 41a. That this is the injury immunized by the lower court is clear from the court's statement that "the anticompetitive injury here resulted from the tobacco companies' conduct after implementation of the [MSA], and not from any further positive action by the States." Pet. App. at 41a.

By so extending the protection of *Noerr-Pennington*, the lower court decision conflicts with several decisions of this Court. The first is *Pennington* itself. *United Mine Workers v. Pennington*, 381 U.S. 657 (1965). That case limited the protection for petitioning activity to the petitioning activity itself.

In *Pennington*, a group of large coal mine operators, together with a union, petitioned the Secretary of Labor and the TVA to set up minimum wages in coal mines supplying the TVA. *Id.* at 660. This Court explicitly denied protection to certain of the resulting anticompetitive restraints implementing that petitioning activity that were directed at driving small mine operators out of business. *Id.* at 663. This Court explained that if "the union became a party to a collusive bidding arrangement designed to drive [plaintiff] and others from the TVA spot market, we think any claim to exemption from antitrust liability would be frivolous at best." *Id.*

In the same vein, this Court's rulings in *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492 (1988) and *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411 (1990), recognized that restraints of trade, even though closely connected to petitioning activities but undertaken by private parties unsupervised by any governmental body, are not immunized under *Noerr-Pennington*.

Allied Tube held that the adoption by state and local governments of an electrical code for buildings did not immunize the restraints undertaken by the steel tube manufacturers that petitioned to get the code enacted to eliminate a plastic tube manufacturer as a competitor. It stated:

> . . . we hold that at least where, as here, an economically interested party exercises decision-making authority in formulating a product standard for a private association that comprises market participants, that party enjoys no *Noerr* immunity from any antitrust liability flowing from the effect the standard has of its own force in the marketplace.

Id. at 509-10. This holding is particularly apposite here in light of the lower court's conclusion that the States exercise no active supervision of the operations of the cartel. In fact, the lower court pointed out:

> The States here are actively involved in the maintenance of the scheme, but they lack oversight or authority over the tobacco manufacturers' prices and production levels. These decisions are left entirely to the private actors. Nothing in the Multistate Settlement Agreement or its Qualifying Statutes give the States authority to object if the tobacco companies raise their prices. In fact, it appears these increases have already happened. As noted, the Majors have raised their prices sharply and uniformly since the implementation of the Multistate Settlement Agreement according to plaintiffs, by 50% since 1997. *See* Complaint at ¶ 36. These price increases have not been monitored or regulated by the States. The Multistate Settlement Agreement imposes no restrictions on pricing or provisions to temper the effects of the output cartel.

Pet. App. at 56a-57a.

Similarly, in *Trial Lawyers*, the public defenders of the District of Columbia engaged in a concerted refusal to represent indigent defendants in order to pressure the District into raising the hourly rate paid. *Trial Lawyers*, 493 U.S. at 414-19. This Court held that the defendants could be held liable under the Sherman Act for injuries that resulted directly from the boycott, even though the boycott was intended to secure government action. *See also Patrick v. Burget*, 486 U.S. 94, 100-01 (1988).

The illegal acts here dovetail with the Examples II and III posited by 1 PHILIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW*, ¶ 229 (2d ed. 2000), as being unprotected by *Noerr*, where they point out:

> The private party is not immune where the operative restraint results from its own private action inadequately supervised by government pursuant to a policy to displace the antitrust laws.

Id. at 519.

The Opinion also conflicts with, and would extend the state action immunity doctrine of *Parker v. Brown* to cover interstate commerce without any limitations. Through the restrictions on the output of the Majors' small competitors, the MSA has displaced competition with an output cartel designed to allow the Majors to raise prices without losing market share. *Parker* holds that anticompetitive actions by the states in their governmental capacities as sovereign regulators are not barred by the antitrust laws. *Parker v. Brown*, 317 U.S. 341, 352 (1943). *Parker* immunity, however, must satisfy several conditions to be effective. One such condition emphasized by *Parker* itself, 317 U.S. at 362-63, is that the restraint must relate to the state's local, intrastate activities. *Id.* at 359-63. Another was expressed in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), which held that when private parties purport to act pursuant to state action, the action must be clearly articulated state policy and closely supervised by the state. *Id.* at 105. By immunizing the unsupervised acts done on a nationwide scale by implementing this output cartel, the Opinion read these initial limitations out of existence.

The effect of the Opinion expands the local activity limitation inherent in the state action immunity doctrine beyond its judicially recognized boundaries. The state action doctrine is based on the right of a state to regulate matters of local interest and conduct occurring within its borders. There is no such thing as "interstate action immunity." If that were not the case, every nationwide anticompetitive restraint embodied in a settlement made between a group of competing private firms and a state or group of states would be entitled to antitrust immunity. Such immunity would exist even though the restraint pervasively controls interstate commerce. If federal officials in the executive branch lack the power to grant such dispensation, and they do,[19] it is an anomaly to hold that state officials are imbued with such power, particularly since this Court has ruled that state officials

19. *See Otter Tail Power Co. v. United States*, 410 U.S. 366, 378-79 (1973); *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 13 (1979).

and even state legislatures lack such power. *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621, 631 (1992); *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384 (1951).

The importance of these issues is manifested by the fact that the decision below, in finding that no state action exists with respect to the output cartel, presents an anomaly in the future enforcement of the antitrust laws. For example, the protections of *Noerr-Pennington* extend only to private parties — in this case the Majors; the states have no similar *Noerr-Pennington* protection. Thus, if wholesalers or consumers sue to enjoin the states from enforcing the MSA's output restrictions, the wholesalers and consumers would prevail on any immunity issue as a matter of law, because, as the court below found, the output restraints fail to satisfy the requirements of state action. Pet. App. at 51a-60a. Thus, the effect of the decision below is that a restraint may be enjoined if it fails to qualify for state action protection in a case brought against a state; yet, the same restraint cannot be enjoined when the private parties who agreed to the restraint and act in furtherance of it are sued and claim *Noerr-Pennington* protection on the basis that they asked for the restraint. This Court has made clear that the scrutiny a restraint of trade must receive cannot turn on which parties to the restraint — private entities or states — are sued. *Southern Motor Carriers Rate Conf. v. United States*, 471 U.S. 48, 58 (1985). ("The success of an antitrust action should depend upon the nature of the activity challenged, rather than on the identity of the defendant.") A suit against either should yield the same result.

Further uncertainty and confusion in this area, which again can only be cleared up by this Court's granting this petition, arises from conflicting rulings, albeit at the district court level, with respect to immunization of the output cartel and the MSA under the antitrust laws. These are *Hise v. Philip Morris*, 46 F. Supp. 2d 1201 (N.D. Okla. 1999), *aff'd in an opinion not for publication*, 208 F.3d 226 (10th Cir. 2000), *cert. denied*, 531 U.S. 959 (2000), two other unrelated actions involving gray

goods (*i.e.*, U.S. cigarettes sold for export and imported back into this country), *Premium Tobacco Stores, Inc. v. Fisher*, 51 F. Supp. 2d 1099 (D. Colo. 1999) and *PTI, Inc. v. Philip Morris Inc.*, 100 F. Supp. 2d 1179 (C.D. Cal. 2000),[20] as well as another consumers' class action under 42 U.S.C. § 1983 *et seq.* which in effect challenged the price increases after the MSA as illegal taxes. *Forces Action Project LLC v. California*, No. C 99-0607, 2000 WL 20977 (N.D. Cal. Jan. 5, 2000). The district court in *Forces Action* found absolute immunity under the Eleventh Amendment and did not permit the consumers there to amend their complaint to allege that the MSA contains unreasonable restraints of trade. *Id.* at *2-7. The District Court held that the consumers, as indirect purchasers, did not have standing to seek injunctive relief based on a violation of the antitrust laws. *Id.* The Ninth Circuit, however, reversed and remanded the case to the district court. *Forces Action Project LLC v. California*, No. 00-15280, 2001 WL 923124 (9th Cir. Aug. 15, 2001). Although the Ninth Circuit had been advised of the Third Circuit's ruling on state action immunity, its *per curiam* reversal did not explicitly address the issue, but it did allow the plaintiffs to seek an amendment to plead the antitrust case against these state officials. *Id.* at *1-2.

This Court should resolve these issues by brightening the demarcation line between *Noerr-Pennington* and *Parker*, and reaffirming that *Noerr-Pennington* governs the petitioning, while *Parker* governs the result of the petitioning.

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20. *Hise* was a consumers' class action seeking antitrust treble damages on conclusory and unsubstantiated charge of price fixing. The opinion in *Hise* did not discuss state action immunity because it was the first case involving the MSA and that defense apparently never occurred to the Majors at that time. As to the *Noerr* immunity issue, the Majors responded to plaintiffs' amicus brief by explaining to the Tenth Circuit that the complaint in the instant case was "premised on factual allegations not part of the record [in *Hise*]" and that "the theory that the MSA allegedly involved unlawful output restrictions . . . [was] inapposite [in *Hise*]." JA 662.

1 PHILIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW*, ¶ 229 (2d ed. 2000), expresses the correct rule this way:

> As a result, (a) the private party is immune for requesting an anticompetitive statute or government order later found not to have *Parker* immunity; but (b) the private party may not be immune for its actions subsequently undertaken under this nonimmune statutory regime, particularly for its unsupervised anticompetitive conduct.

Id. at 519.

2. The Court Below Incorrectly Applied the *Noerr-Pennington* Doctrine

Although the Opinion correctly ruled that the doctrine of state action does not immunize the illegality of the price increases that the Majors implemented after executing the MSA, it never explains why they are protected under *Noerr-Pennington*. The antitrust injuries sued on herein flow from the Majors' implementing the output cartel and raising prices by $7.60/carton up through January 17, 2000 (Pet. App. at 16a, n.22, 20a-21a) and another $1.00/carton in April 2001. As the Opinion points out, the illegality of these price increases implementing the output cartel cannot be protected under the state action immunity doctrine because the States had no supervision over these price increases, since they "are left entirely to" the Majors. Pet. App. at 55a-56a.

Here, as reveled by the Opinion's own analysis of the antitrust injuries (Pet. App. at 16a-23a), as well as to why state action immunity is unavailable (Pet. App. at 45a-60a), the antitrust harm sustained by plaintiffs results *solely* from private action. The Opinion here conflicts with the rule that where the direct antitrust injury is attributable to acts of the private party, those acts are not immunized under *Noerr-Pennington*. *Pennington*, 381 U.S. at 671 (no recovery permitted for damages resulting from *government's* actions); *Allied Tube*, 486 U.S. at 500 (where "restraint of trade . . . is the result of valid governmental action, *as opposed to private action*," there is immunity) (emphasis added). Having held that plaintiffs' harm

resulted from private action, not government action, the Third Circuit was bound to then apply *Pennington* and *Allied Tube* and hold that the *Noerr-Pennington* doctrine does not apply.

3. The Court Below Has Decided an Important Question of Federal Law That Has Not Been, But Should Be, Definitively Settled by this Court: Whether *Noerr-Pennington* Immunity Should Be Extended To Settlement Agreements With States

The law has long been clear that restraints of trade incorporated into a settlement agreement have no immunity from the Sherman Act. *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 13 (1979) ("*BMI*") (no immunity extends to a consent decree entered into with the Department of Justice nor the acts of private parties contemplated by that decree); *United States v. Singer Mfg. Co.*, 374 U.S. 174 (1963) (settlement agreement that incorporates restraints of trade violate the Sherman Act); *Hartford-Empire Co. v. United States*, 323 U.S. 386, *clarified*, 324 U.S. 570 (1945) (settlement unlawful as part of scheme to monopolize). Two recent decisions by the Circuit Courts of Appeal have also addressed whether the *Noerr-Pennington* doctrine immunizes restraints of trade agreed to in the context of settling litigation. *Primetime 24 Joint Venture v. Nat'l Broadcasting Co., Inc.*, 219 F.3d 92 (2d Cir. 2000) (horizontal agreement cannot be immunized by existence of a common lawsuit); *Andrx Pharm., Inc. v. Biovail Corp.*, 256 F.3d 799 (D.C. Cir. 2001) ("private settlement agreement resolving [ ] patent infringement litigation by substituting a market allocation agreement . . . would not enjoy *Noerr-Pennington* immunity"); *see also In re Cardizem CD Antitrust Litig.*, 105 F. Supp. 2d 618 (E.D. Mich. 2000) (same).

The Opinion does not dispute this general proposition; instead, it sets up a special rule for settlement agreements with states. In doing so, however, the lower court virtually invited review by this Court when it observed that, "[t]he Supreme Court has yet to speak definitively on extending petitioning immunity

to settlement agreements with sovereign states." Pet. App. at 30a. This Court should address this important issue.

In extending the *Noerr-Pennington* doctrine to settlement agreements with sovereign states, the Opinion misapprehended the basic nature of the petitioning process as it pertains to litigation. Adversaries do not petition each other in litigation within the meaning of *Noerr-Pennington*. Rather, they petition the tribunal that they are seeking to resolve their dispute, be it a court, zoning board, taxi commission or other administrative tribunal. In litigating the cases culminating in the MSA, the states and the Majors were not petitioning each other. The states, as adversaries to the Majors, were petitioning the courts to force the Majors to pay them money to reimburse them for healthcare costs, and the Majors, as adversaries to the States, were petitioning those same tribunals for a ruling of no liability. *See Philip Morris v. Blumenthal*, 123 F.3d 103 (2d Cir. 1997).[21]

This Court's ruling in *BMI* rejecting the proposition that a restraint embodied in a consent decree entered into with the Antitrust Division of the Department of Justice entitles the a party to antitrust immunity should be equally applicable to cases where a state or group of states are in litigation. There this Court held:

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21. One observer, critical of the decision below, said:

> The trouble is that 'petitioning' by settling a lawsuit is very different from, say, lobbying one's legislature. Usually, petitioning the government takes place as part of a public debate. Competitors or consumers who might be disadvantaged by what lobbyists are seeking typically have a chance to see what's coming and to voice their objections.
>
> But the tobacco settlement was concocted behind closed doors. Smokers, wholesalers, competitors and others profoundly affected had no opportunity to oppose it. Legislatures and governors had little chance to alter the complex new industry structure the tobacco firms got the attorneys general to approve.

D.J. Tice, "States on Big Tobacco's Side After Smoke Clears," St. Paul Pioneer Press, Aug. 31, 2001.

> Of course, a consent judgment, even one entered at the behest of the Antitrust Division, does not immunize the defendant from liability for actions, including those contemplated by the decree, that violate the rights of nonparties.

BMI, 441 U.S. at 13.

The Opinion sought to distinguish *BMI* by asserting that it did not involve a settlement agreement. Pet. App. at 30a. But a consent decree *is* a settlement agreement. That the settlement becomes embodied in a judicial document and then is so ordered by a judge does not in any way nullify the fact that it is a settlement agreement. Indeed, the MSA envisages that each state will present a consent decree in the form annexed to the MSA as an exhibit. JA 159-60 (MSA § XIII); JA 201-07 (MSA Exh. L). The Opinion also suggests (Pet. App. at 30a-31a) that *BMI* is distinguishable because the issue of *Noerr-Pennington* immunity was not discussed in that case. *Noerr*, however, was decided in 1961, *Pennington* in 1965 and *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508 (1972), in 1972, which removes any doubt that *Noerr-Pennington* covered the conduct of litigation. By 1978, when *BMI* was argued, that doctrine had become well known and firmly embedded in the antitrust law. That the members of this Court as well as the experienced antitrust lawyers in *BMI* recognized the obvious proposition that the Constitutional protection for the petitioning process did not cover deals made between litigants, even when one of the adversaries is a federal government, is no reason for reaching a contrary result when one of the adversaries is a group of states.

Finally, the Opinion's reliance on *Campbell v. Chicago*, 823 F.2d 1182 (7th Cir. 1987) as supporting precedent is misplaced. Pet. App. at 30a-31a. The Seventh Circuit did not "recognize[] the application of *Noerr-Pennington* immunity to settlements between private parties and state government." Pet. App. at 29a-30a. What *Campbell* involved was a suit by a group of taxicab operators as well as their lobbying the City of Chicago

for an ordinance seeking in effect a local monopoly for a group of taxicabs. 823 F.2d at 1183. All the Seventh Circuit held was that the *process* of petitioning the City of Chicago, both by lawsuit and lobbying, was protected activity under *Noerr-Pennington*. *Id.* at 1185-87. When it came to the issue of immunity of the local monopoly resulting from that petitioning, the Seventh Circuit, again quite correctly, held that it was governed by the rules pertaining to the state action doctrine. As the Seventh Circuit stated in *Campbell*:

> It is important to identify the source of the injury to competition. If the injury is caused by persuading the government, then the antitrust laws do not apply to the *squelching* (*Parker v. Brown*) or the *persuasion* (*Noerr-Pennington*).

Id. at 1186. (Emphasis added). The persuasion process in *Campbell*, the petitioning of the courts and lobbying, is *Noerr-Pennington* activity, and the squelching of competition resulting from the local ordinance is classic state action.[22] Thus, *Campbell* does not "resonate[]" with the Opinion's conclusion on *Noerr-Pennington* (Pet. App. at 30a); but conflicts with it.

In summary, the Opinion articulates no defensible rationale for its creation of this new, and, we submit, dangerous expansion of the *Noerr-Pennington* doctrine, which encompass agreements to restrain trade put into settlement agreements made by private firms with states that have sued them.

4. The Court Should Address the Issue of Whether the Supremacy, Commerce and Compact Clauses Preclude *Noerr-Pennington* Immunization of the Interstate Output Cartel

The issues of whether the operation of a cartel controlling the nationwide output of cigarettes constitutes a direct

22. Regulating local cab companies is quintessential local state action activity. *See, e.g., Charley's Taxi Radio Dispatch Corp. v. SIDA of Hawaii*, Inc., 810 F.2d 869 (9th Cir. 1987); *Independent Taxicab Drivers' Employees v. Greater Houston Transp. Co.*, 760 F.2d 607 (5th Cir. 1985).

interference by the collaborating states with interstate commerce and directly conflicts with § 1 of the Sherman Act present two sides of the same coin. The criteria for determining whether a restraint of trade imposed by a state directly interferes with commerce are the same as those used to determine whether it directly conflicts with the Sherman Act. 2 RONALD D. ROTUNDA & NOWAK, *TREATISE ON CONSTITUTIONAL LAW, SUBSTANCE AND PROCEDURE*, § 11.1, at 130-31 (3d ed. 1999). Compare preemption cases such as *Rice v. Norman Williams Co.*, 458 U.S. 654, 659-62 (1982), and *Schwegmann Bros. v. Calvert Distillers Corp.*, *supra*, with *Healy v. Beer Institute, Inc.*, 491 U.S. 324, 332 (1989), holding that a state imposed restraint which "has the 'practical effect' of regulating commerce occurring wholly outside that State's border is invalid under the Commerce Clause."

The direct interference with interstate commerce in violation of the Commerce Clause is at the heart of the issue raised in this case: can the major competitors in an industry collaborate with a group of states to control that nationwide industry by placing restraints in a settlement agreement with those states? The decisional law applying the dormant Commerce Clause indicates that this is impermissible. *See Bacchus Importers, Ltd. v. Dias*, *supra*; *Quill Corp. v. North Dakota*, *supra*; *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573 (1986).

In addition, the MSA's interference with interstate commerce is exacerbated by its advertising and promotion provisions not only being in direct conflict with the FCLAA, but being an integral discriminatory facet of the implementation of the output cartel. The MSA advertising provisions constitute a sweetheart deal between the Majors and the lawyers for the states by giving the Majors, and no other manufacturers, grandfather rights for brand name sponsorships, giveaways of merchandise and sports promotions. JA 108 (MSA §§ III(c)(2)(ii)); JA 108-09 (MSA § III(c)(3)); JA 110 (MSA § III(f)); JA 111 (MSA § III(i)). No one else gets these deals.

A small manufacturer, however, can only avoid these advertising restrictions in the MSA by becoming an NPM. Thus, a small manufacturer is jammed into a classic Catch-22 quandary. The only way it can avoid the non-deductible penalties imposed on an NPM is to become an SPM. But if it becomes an SPM, it forfeits its First Amendment rights to advertise. Either way the Majors throttle the ability of small companies to compete. This deprivation on an interstate scale of the constitutionally guaranteed advertising advantages and promotional advantages that they would otherwise be legally permitted to enjoy burdens commerce. *See Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935).

Most importantly, however, the stated objective of the Renegade Clause and the Escrow Statutes of "effectively and fully neutralizing the cost disadvantages" imposed on the Majors directly interferes with interstate commerce. Small manufacturers which are forced to join the MSA as SPM's or to pay penalties imposed by the Escrow Statutes are impermissibly deprived of a substantial cost advantage in interstate commerce. The MSA payments to any given state are determined *solely* by and depend upon an SPM's total sales in interstate commerce, with no relation to the local activity that it conducts in that state. The Escrow Statute penalties paid to any given state reach across state borders to NPM's whose business is confined to another state but whose products are transported and sold in that state by others. The result of penalizing the interstate sales of both SPM's and NPM's to avoid the loss of market share by the Majors that would normally flow from their substantial price increases is the restriction of output on an interstate scale. Such an interstate regulatory scheme is impermissible interference with interstate commerce. *Baldwin*, 294 U.S. at 524 (striking down state law that had the effect of eliminating the competitive advantage enjoyed by Vermont dairy farmers by equalizing the price of milk from all sources, including interstate ones).

The practical effect of the Escrow Statutes, in conjunction with the Renegade Clause "is to create just the kind of competing

and interlocking local economic regulation that the Commerce Clause was meant to preclude." *Healy*, 491 U.S. at 337. The MSA's total regulation of interstate commerce engaged in by *all* makers of U.S. cigarettes clearly violates the Commerce Clause. *See Edgar v. MITE Corp.*, 457 U.S. 624, 642-43 (1982).

This Court should also rule on whether the Compact Clause, U.S. Constitution, Art. I, § 10, cl.3, prohibits the states' mutual surrender of state sovereignty, both to themselves and to the Majors, for the purpose of effectuating this output cartel. In the court below, the Majors argued that the Compact Clause is not violated because it is restricted only to contracts made between the States themselves and not between the States on the one hand and private parties on the other. This Court has never ruled on that issue.

This Court has interpreted the Compact Clause as prohibiting the States from forming, without the consent of Congress, "any combination tending to the increase of political power in the states, which may encroach upon or interfere with the just supremacy of the United States." *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 468 (1978) (quoting *Virginia v. Tennessee*, 148 U.S. 503, 519 (1893)); *id.* at 471 (same). Under this construction of the Clause, the "relevant inquiry must be one of impact on our federal structure." 434 U.S. at 471. Thus, although a compact clause issue is also akin in large measure to a preemption analysis, it differs in one respect that merits consideration by this Court. Preemption hinges upon a direct conflict between the States and federal law, but a compact made between States without congressional consent is invalid if it "tend[s] to the increase" of state power or if it "may" encroach upon or interfere with federal powers. *Id.* at 493. Consequently, "the pertinent inquiry is one of *potential*, rather than actual, impact on federal supremacy." *Id.* at 472 (emphasis added).

The MSA not only lacks congressional consent but also was made only after Congress rejected the proposed output cartel subsequently embodied in the MSA. Pet. App. at 7a. Thus, in

assessing compliance with the Compact Clause, the question under the test of *United States Steel*, is whether the MSA tends "to the increase of political power in the states, which may encroach upon or interfere with the just supremacy of the United States." 434 U.S. at 468.

Turning to the violation of the Compact Clause, the MSA meets all of the requirements for an unconstitutional interstate compact set forth in *United States Steel Corp.*, 434 U.S. at 473.

1. It interferes with the exercise of powers held by the federal government.
2. It is a surrender of state sovereignty to private parties which are appointed pursuant to the mechanisms set up in the MSA. In the event that a non-severable provision is invalidated, only the Majors, not the states, have the right to terminate the agreement. JA 167-68 (MSA § XVIII(o)).
3. Finally, it allows the states which have joined the agreement to exercise powers that they could not do so in the absence of that agreement. As noted above, both the MSA and the Escrow Statutes explicitly seek to raise revenue on the basis of the interstate business of SPM's and NPM's. That is a power reserved to the federal government.

5. The Court Below Improperly Concluded that The Constitutional Objections To Antitrust Immunity Defenses Were Not Raised in the District Court

The Third Circuit in refusing to rule on these constitutional issues, in effect has given a *sub silentio* blessing to the notion that agreements such as the one presented here do not run afoul of the Commerce, Supremacy or Compact Clauses. The Opinion avoided confronting this unconstitutional encroachment upon the enumerated powers of the present government for two reasons: 1) it ruled that the petitioners had an obligation to raise these objections to the application of *Noerr-Pennington* and state action immunity in their complaint, and 2) that the petitioners did not raise these constitutional issues in the trial

court. Pet. App. at 60a-61a. The first reason is legally untenable and the second factually inaccurate.

With respect to the first reason, the Opinion, in effect, seeks to fashion a new rule of pleading, namely, requiring plaintiffs to raise objections to affirmative defenses in their complaint.[23] The pertinent rule is that allegations in the complaint which seek to avoid or defeat potential affirmative defenses constitute "improper pleading because these allegations are not an integral part of plaintiff's claim." 5 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, *FEDERAL PRACTICE & PROCEDURE*, § 1276 (Civ. 2d 1990).

With respect to the second reason, the Third Circuit is incorrect in asserting that in the trial court the plaintiffs did not argue that the affirmative defenses of antitrust immunity, *i.e.*, both *Noerr-Pennington* and state action immunity were unavailable in light of the invalidity of the MSA under both the Commerce, Compact and Supremacy Clauses. JA 617-21. The Amended Complaint, in fact, challenged the constitutionality of the MSA under both the Commerce Clause and Compact Clause. JA 688 (Am. Cmplt. ¶ 65), JA 698-99 (Am. Cmplt. ¶102). Indeed, the plaintiffs not only raised the unavailability of these affirmative defenses of antitrust immunity in the trial court, but also the Majors' principal argument was that the protection of the right to petition embodied in the *Noerr-Pennington* doctrine overrode any such constitutional infirmities as a direct interference with interstate commerce, a direct conflict with the Sherman Act, or violation of the Compact Clause. JA 624-627. Although the Third Circuit did not discuss the issue of preemption under the Supremacy Clause, *i.e.*, a direct conflict with § 1 of the Sherman Act, that issue was also raised by petitioners as a reason for rejecting the applicability of *Noerr-Pennington* doctrine in both the Third Circuit and the trial

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23. The *Noerr-Pennington* immunity claim is, of course, an affirmative defense. *Bayou Fleet, Inc. v. Alexander*, 234 F.3d 852, 860 (5th Cir. 2000), *cert. denied*, 121 S. Ct. 1228 (2001); *North Carolina Elec. Membership Corp. v. Carolina Power & Light Co.*, 666 F.2d 50, 52 (4th Cir. 1981).

court.[24] Moreover, both petitioners' main brief in the Third Circuit (at 30), as well as their reply brief (at 14 at n.10) pointed out these issues of unconstitutionality had been raised in the court below as reasons for the unavailability of the *Noerr-Pennington* doctrine.

Petitioners submit as to whether the MSA violates these constitutional protections against interference by the States with the national economy is a matter of national significance which the Court should decide.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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24. With respect to the trial court proceedings, the violations of the Constitution were pleaded in the Amended Complaint at paragraphs 65 and 102 (JA 688, 698), and Plaintiffs' Brief in Opposition to Motion to Dismiss, Docket No. 27, citing and relying on the seminal case on Sherman Act preemption, *Northern Securities Co. v. United States*, 193 U.S. 197, 345 (1904) at 4 and 18 at n. 21 (JA 620), as well as *Schwegmann Bros. v. Calvert Distillers Corp.*, *supra*, at 7. With respect to the proceedings in the Third Circuit, *see* Plaintiffs' Opening Brief at 52-53, citing and discussing *Northern Securities* and *Rice v. Norman Williams*, 458 U.S. 654 (1982); Reply Brief at 2, 4 and 15, also citing and discussing *Northern Securities* and *Rice*.

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